EXCEPTION

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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF JOHNSON UTILITIES, LLC FOR AN INCREASE IN ITS WATER AND WASTEWATER RATES FOR CUSTOMERS WITHIN PINAL COUNTY, ARIZONA.

Docket No. WS-02987A-08-0180

RESIDENTIAL UTILITY CONSUMER OFFICE'S EXCEPTIONS

The Residential Utility Consumer Office ("RUCO") files these exceptions to the Recommended Opinion and Order ("ROO") issued on March 9, 2010 regarding Johnson Utilities, LLC's ("Johnson" or "Company") rate application. RUCO believes that overall, the ROO is fair, well-reasoned and should be approved by the Commission. While not every position advocated by RUCO was adopted, RUCO's exceptions are limited to three issues – the ROO's 10% proposed operating margin, the proposed remedies for the Company's environmental violations, and an accounting error associated with the CAGRD expense.

OPERATING MARGIN

The ROO recommends a 10% operating margin for both the water and wastewater divisions. An operating margin may be applied in situations where a Company has a negative rate base. Here, the ROO recommends a negative rate base for both the water and the wastewater divisions.

The Commission should take a very hard look at the recommended operating margin for the very reasons set forth in the ROO.

> Authorizing an operating margin for a utility the size of the Company is problematic. Any part of an operating margin that is not used to cover legitimate utility expenses would accrue to the utility as income. Allowing a utility to collect an operating margin in rates has the potential to allow the utility to accrue a net income similar to the return earned by a utility that has made an investment in plant. In other words, authorizing an operating margin when there is no rate base investment has the potential of allowing the utility to realize a profit without making any investment, creating a windfall for the utility, without the utility having put any capital at risk.
>
> We do not wish to reward the Company for having a negative or negligible rate base. However, neither do we wish to have the Company's customers placed in jeopardy as they might be if the Company is unable to meet its legitimate operating expenses.

ROO at 50-51- footnotes omitted.

What makes the present case different from the normal situation where an operating margin is being considered is the amount of equity in the Company's capital structure. The Company's actual capital structure is ***all*** equity[1], which means that the Company has significant cash flows. The Company's cash flow can be measured by adding its depreciation expense to its operating income. The cash flow in this case will not be needed to pay off debt. An operating margin is appropriate when there is a concern that the Company is unable to maintain enough cash flow to meet its expenses and debt service and provide service to its customers. That is not a great concern here.

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[1] At the time of the hearing, the Company's capital structure included debt which consisted of a loan which was scheduled to be paid off on December 31, 2009. R-8 (Rigsby Direct – Attachment F). Assuming this loan was paid off, the Company no longer has any debt service obligations that RUCO is aware of.

Another way to look at it is to consider, if approved, what an operating margin would equate to in terms of rate base. RUCO has done an analysis which is set forth as follows:

PRO FORMA RATE BASE CALCULATION

Water Division

	ROO	RUCO
Recommended Operating Income	$ 1,307,438	$ 921,091
Divided By: Recommended Operating Margin	10.00%	8.18%
Pro Forma Rate Base	$ 13,074,380	$ 11,260,281

Wastewater Division

	ROO	RUCO
Recommended Operating Income	$ 1,045,913	$ 838,192
Divided By: Recommended Operating Margin	10.00%	8.18%
Pro Forma Rate Base	$ 10,459,130	$ 10,246,846

The conclusion is for the water division, an operating margin[2] of 10% would be the same as awarding the Company a FVRB of $13,074,380. For the wastewater division, an operating margin of 10% would be the same as awarding the Company a FVRB of $10,459,130. This is simply too much, would reward the Company for a negative rate base and establish rates that are not just and reasonable under the circumstances. It could set a

[2] RUCO has provided the same calculation using its recommended operating margin of 8.18% applied to the ROO's recommended operating income adjusted for the CAGRD error explained more fully below.

precedent which would promote the concept of a negative rate base which is contrary to the public interest.

RUCO recommended the application of its 8.18 WACC as the operating margin for the water division. If the Commission were to determine a negative rate base for the wastewater division, RUCO would make the same recommendation of no more than 8.18% be applied as an operating margin. This recommendation represents the highest number RUCO would recommend to achieve what RUCO believes is the ROO's purpose. RUCO would certainly support a lower number if the Commission were to feel so inclined. Given the Company's cash flows, the record would clearly support an operating margin lower than 8.18%.

ENVIORNMENTAL REMEDIES

RUCO is deeply troubled by the evidence in the record concerning the Company's environmental violations. From RUCO's perspective, the ROO acknowledges the problems but offers no solutions.

One would have to turn a blind eye to not recognize a problem that affects the public's health and safety from the evidence in the record. Perhaps even more alarming is the Company's attitude toward the problem, and the Company's attitude toward remedying the problem. The ROO dismisses the evidence regarding Johnson's numerous environmental violations because it is not "first hand." However, the Commission is not bound by the heresay rules of evidence. ARS §40-243(A) states:

> A. All hearings and investigations before the commission or a commissioner shall be governed by this article, and by rules of practice and procedure adopted by the commission. Neither the commission nor a commissioner shall be bound by technical rules of evidence, and no informality in any proceeding or in the manner of taking testimony before the commission or a commissioner shall invalidate any order,

> decision, rule or regulation made, approved or confirmed by the Commission.

Therefore, Arizona law specifically permits the Commission to consider the evidence in the record and to accord it the weight it deems proper. In RUCO's opinion, the Commission should give great weight to the evidence presented of Johnson's violations and order the relief RUCO recommends in its Brief.

Moreover, as suggested above, the preponderance of the evidence standard goes to the "weight" of the evidence, not the type of evidence. See, for example Doubek v. Greco, 7 Ariz. App. 102, 104-105 436 P.2d 494, 496-497 Ariz. App. 1968. The Arizona Supreme Court has defined preponderance of the evidence as follows:

> By preponderance of the evidence is meant such proof as satisfies the conscience and carries conviction to an intelligent mind. *North Chicago St. R. Co. v. Fitzgibbons*, 180 Ill. 466, 54 N.E. 483. It does not necessarily depend upon the number of witnesses. The capacity of the submitted testimony to enforce belief upon the arbiters of fact to whom it is submitted is the touchstone of preponderance as applied to the testimony of witnesses. *McKee v. Verdin*, 96 Mo. App. 268, 70 S.W. 154. In other words, the ultimate test is, does the evidence convince the trier of fact that one theory of the case is more probable than the other. In cases of this nature, the commission is the trier of fact, and, as we have repeatedly said, unless its conclusion is arbitrary and cannot be supported on any reasonable theory of the evidence, we are bound thereby, even if we, sitting as triers of fact, would reach a different conclusion on the evidence.

Cole v. Town of Miami, 52 Ariz. 488, 497, 83 P.2d 997 1006 Ariz. 1938.

The standard is not based on the type of evidence, but the weight of the evidence. Whether the evidence is first hand or not, should not be controlling. What is controlling is whether the evidence in the record lends the Commission to the conclusion that it is more probable than not that the violations occurred, and the public health and safety is at risk. From the evidence in the record it would be impossible to conclude that the violations did not occur, given the testimony. Brian Tompsett, the Company's Vice President, was asked at the hearing about the Notice of Violations in general and if there was any validity to them. Transcript at 743. Mr. Tompsett's response:

> Q. So do you think there is any validity to any of them?
> A. The letter of the law citing specific statutes, yes, there will be some validity to some of the statutes that are quoted. But I don't think all of the statutes that are alleged, the alleged violations are valid, no.

The Company even validates some of the violations. What is more troubling is why the Company believes it received so many NOV's. Mr. Tompsett believes that ADEQ is out to get the Company:

> Q. What about 2009? It doesn't seem like the company is off to a good start in 2009. Any particular reason there have been these violations in 2009?
> A. Well, I guess the most accurate way to describe that is we have an ongoing dispute with ADEQ over the issuance of notices of violations to Johnson Utilities in particular. It is our opinion that they make a special effort to issue violations, and selectively issue violations to our company rather than others.
>
> Q. So does the Company feel that it is being treated unfairly by ADEQ?
> A. Short answer would be yes.
>
> Q. Do you know why the company – why ADEQ may be singling Johnson Utilities out for these violations?
> A. Well, it is our opinion that they are selectively enforcing more stringently against Johnson Utilities than they do against other companies across the state. And we have done FOIA requests with that in mind, and the evidence that has been presented by ADEQ seems to suggest that that is in fact the case. Transcript at 740-741.

Given this record, the ROO suggests that the Commission require the Company to advise the Commission of all outstanding NOVs, advise the Commission of the status of the NOVs and the efforts the Company is making to resolve the NOVs. ROO at 56-57. RUCO does not oppose the ROO's recommendations, but believes that the Commission, based on the record, should monitor the Company closer at least until the NOVs are cleared up. The ROO criticizes RUCO's recommendations as being duplicative of ADEQ's requirements. ROO at 56. RUCO does not believe its recommendations are any more duplicative than the ROO's recommendations. But even if that was the case, RUCO's recommendations should still be considered. The ROO is correct that the roles of ADEQ and the Commission should not be duplicative. The Commission's role concerns the public's health and safety and the provision of service. ADEQ's role is enforcement. Sometimes in carrying out their respective roles the appropriate remedies may be the same. If additional monitoring is appropriate, the Commission should not rely on ADEQ to carry out the Commission's role.

CAGRD

After the ROO was issued, it was pointed out to RUCO that the amount of gallons RUCO used to calculate its test year CAGRD expense was wrong. RUCO used the test year gallons sold provided in the Company's application – 2,631,314. R-2, Sch. RLM-16, A-1 at 16. The CAGRD fee only applies to the number of gallons sold associated with groundwater, not the total number of gallons. RUCO has made the correction and determined that the correct adjustment is $1,169,923 – see attached Revised CAGRD adjustment.

RESPECTFULLY SUBMITTED this 18th day of May, 2010

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RUCO REVISIONS TO ROO
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 1
CAGRD EXPENSE

LINE NO.	DESCRIPTION	(A) CAGRD GALLONS (in 000's)	(B) CAGRD FEE (per 1,000 Gal.)	(C) CAGRD EXPENSE
		TEST YEAR (Col. C / Col. B)	TEST YEAR (Per CAGRD Website)	TEST YEAR (Per G/L)
1	TEST-YEAR CAGRD FEES - PHOENIX AMA	1,164,969	$ 0.7365	$ 858,000
2	TEST-YEAR CAGRD FEES - PINAL AMA	38,450	$ 0.6721	25,842
3	TOTALS	1,203,419		$ 883,842
	CALCULATION OF THE 2009/2010 CAGRD FEE	NORMALIZED (Per Lines 1 & 2)	2009/2010 (Per CAGRD Website)	NORMALIZED (Col. A X Col. B)
4	CAGRD - PHOENIX AMA	1,164,969	$ 0.976	$ 1,137,010
5	CAGRD - PINAL AMA	38,450	$ 0.856	32,912.9
6	TOTALS	1,203,419		$ 1,169,923
7	ADJUSTED CAGRD FEES			$ 1,169,923
8	RUCO ADJUSTED CAGRD FEES (See RLM-8, Col. (F))			$ 1,169,923